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ANALYSIS OF NATIONAL EXPERIENCES IN HORIZONTAL AND VERTICAL DIVERSIFICATION, INCLUDING THE POSSIBILITIES OF CROP SUBSTITUTION

SOLOMON ISLANDS

Report by the UNCTAD secretariat

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FOREWORD

1. The Committee on Commodities, in its Fourteenth Session, November 1990, decided that priority should be given to the study of the impact of market conditions in importing and exporting countries with regard to diversification, including government policies, structural adjustment, forms and methods of trading, and technical assistance.[1] The Standing Committee on Commodities, at its first session in February 1993, decided, in the same vein, that national experiences in horizontal and vertical diversification, including possibilities for crop substitution, should be analyzed, and that an examination was required of the best ways of achieving diversification, taking into account competitiveness, market trends and opportunities.[2]

2. In accordance with these mandates, a number of country studies are being undertaken, in Cameroon, Colombia, Fiji, Senegal, Solomon Islands and United Republic of Tanzania. The experience of these countries in the diversification of their commodity exports (both horizontally into non-traditional primary commodities and vertically into semi-processed and processed products) as well as the conditions influencing this are analyzed. These conditions fall in two broad areas: the macro-economic and international environment (including market access conditions), and the commodity-specific supporting framework (in terms of government -or otherwise- supplied infrastructure, services, etc.).

3. The approach attempts to identify the key factors which made commodity export diversification happen, or which prevented the exploitation of diversification possibilities. This includes questions as to which were the important factors which led to and facilitated the set-up of new export-oriented productive activities; what were the problems these new activities encountered, and, if these problems were overcome, how this was done. If problems were not overcome, were there gaps in the supporting environment, and in particular, in government policies? It is difficult to assess the impact of each policy measure separately because of their complementary nature and the pervasive influence of weather conditions on agriculture production. The studies thus attempt to analyze which package of conditions is necessary to make export diversification viable, and which package of policy measures seems to enhance the chances of export diversification efforts, rather than to determine, for example, whether cheap credits are more useful for an exporting company than good market information networks.

4. Therefore, the goal of these studies is not to formulate general theoretical statements, neither is it to formulate specific policy recommendations for the countries being studied. Rather, it is to draw conclusions on the sorts of policies that would facilitate diversification, the support services that are absolutely necessary to enable local entrepreneurs to make use of existing possibilities, and the ways a country can improve its benefits from the marketing of its commodities. Presently, many countries are in a process of policy reform; diversification of exports is generally one of the envisaged outcomes. However, the resources available to stimulate this diversification are scarce, and in general countries do not have the information necessary to determine how their resources can be used optimally. These studies will, it is hoped, support the process of policy formulation in developing countries in this area.

5. The Solomon Islands was selected for a country study as it is one of the two beneficiary countries of the pilot project coordinated by UNCTAD on commodity processing being financed by the Government of Japan and UNDP for selected developing countries. This project is promoting local processing in selected highly commodity-dependent developing countries in cooperation with all relevant international agencies (UNCTAD, UNDP, FAO, UNIDO, World Bank and regional development banks) as well as beneficiary governments and foreign and local investors. As the first step in implementing the project an independent and realistic assessment of the commodity sector of the Solomon Islands has been carried out in terms of its vertical diversification potential. The bulk of statistical and other information used in this paper is based on that provided by Mr. G. J. Ryland' a project consultant who visited the Solomon Islands in 1993.

SUMMARY AND CONCLUSIONS

6. The Solomon Islands is a small island developing country with a very high proportion of commodities in its export earnings and rather limited results as regards the diversification of its production and export structures. The country is characterised by a widely dispersed territory, related high transport costs and a small and fragmented domestic market. It is rich in natural resources (especially forest and marine resources). Exploitation of these resources has been negatively affected by the regular occurrence of cyclones. Although these and several other unfavourable basic factors place certain limits on the development of diversification activities, these factors cannot be considered as decisive barriers to diversification as they can be mitigated or circumvented by the implementation of appropriate policies and measures.

7. Limited domestic savings potential and chronic shortage of internal financial resources constitute a major constraint to local investment. This explains the high reliance on external financial and technical assistance. Economic activity is also constrained by the poor state or lack of infrastructure as well as by a general severe shortage of local technical, managerial and marketing skills. However, classified as a least developing country and benefiting from advantages under the Lomé Conventions, the Solomon Islands faces very few access barriers to the export of its commodities in all major markets.

8. Macroeconomic instability, among others constraints, has resulted in an overall environment which was not generally conducive to increasing private investment in diversification-related activities. The involvement of the Government as a partner in these activities through statutory authorities and parastatal corporations has not led to the results expected from this measure, while its contribution to creating an environment favourable for private investment in diversification activities has to date been quite limited. As a consequence, the country has very few results to show so far in terms of commodity-related diversification.

9. The Government is now paying increasing attention to attracting foreign investors to diversification-related activities and to promoting exports of non-traditional commodities. It has put in place liberal legislation to support production and exports of these and other products. The selection of sectors to benefit from investment incentives has, however, still to be evaluated carefully by the Government, taking into consideration various factors, including interaction between different sectors, in order to avoid artificial stimulation of inefficient exports to the detriment of other productive activities. Although emphasizing the provision of investment incentives, the Government has paid relatively less attention to providing support services, either directly or through measures encouraging appropriate private-sector initiatives; the lack of access to market information, as well as of support in the areas of marketing, infrastructure and extension services constitute major constraints to the development of commodity-related diversification activities.

10. To provide an efficient stimulus to diversification in the Solomon Islands, the Government will have to play a key role in improving the overall environment for private initiative, encouraging the development of the still small and inexperienced local private sector[4] and promoting cooperation with foreign investors in selected areas. This could be achieved by creating a sound macroeconomic framework and an appropriate and carefully crafted set of policies and measures at both macroeconomic and sectoral levels. Although this set of measures may not be explicitly designed to support only commodity-based diversification activities, it should provide the stimulus necessary to enable existing investment opportunities to be efficiently explored.

Chapter I

RESOURCE SITUATION AND NATIONAL COMMODITY SECTOR

A. Natural resources endowment and basic features of the commodity sector

11. The Solomon Islands is a small island country with a GNP of around US$ 200 million and with a population estimated at around 330 to 340 thousand of which more than 80 per cent live in small coastal villages. The location of the Solomon Islands is remote with respect to major markets. All islands back in a very pleasant tropical climate devoid of climatic extremes. However, the country sustains cyclone damage on a regular basis - for instance, a devastating cyclone in 1986 led to massive destruction of crops and infrastructural facilities. However, both land and sea are rich in natural resources. The principal economic activities consist of the production and export of primary products in agriculture (mainly copra and palm oil), forestry and fishing.

12. About 30 per cent of the country's land mass is cultivable. As in many South Pacific countries, the major constraints on land use and availability are the customary rights determined by various kinship and clan arrangements. About 85 per cent of land and adjacent fishing waters is still held under this system of title, which makes it extremely difficult to transfer land or resource ownership among individuals or from one clan to another or to provide access to these lands by commercial companies. This poses problems for land-based developments including plantation, forestry and mining.

13. The crop production system of the Solomon Islands consists of three sectors - smallholder, communal and plantation production. The rural sector makes up 85 per cent of the population (about 45,000 households), most of whom are engaged in some form of mixed subsistence and cash crop cultivation. The main food crops produced by smallholders are sweet potato, taro, yams and pana, while the main cash crops are coconuts and cocoa.

14. The communal production consists of two cooperative schemes (Land Development Cooperatives and Land Purchase Cooperatives) which were formed primarily to enable indigenous landowners to recover lands from expatriate landowners. There are 29 established cooperatives operating on about 8,500 hectares and these account for around 6 per cent of coconut groves. The cooperative schemes have not lived up to expectations - they are characterized by low yields, low replanting rates and large areas of fallow land.

15. In the plantation sector, which occupies a relatively limited land surface, two joint ventures between the Government and multinational companies (Lever Solomon and Solomon Islands Plantations) produce 100 per cent of the country's coconut oil and palm oil, 60 per cent of the cocoa and 7 per cent of the copra. Together these companies account for 85 per cent of the wage employment in the agricultural sector and about 14 per cent of total wage employment in the Solomon Islands. The plantation sector uses modern methods of production and its productivity is close to that in other countries.

16. The main trends in the production of major agricultural commodities, shown in Table 1, reveal a persistent rise trend in the production of cocoa, which is of growing importance for rural households, a net decline in copra production and cattle slaughtering, while palm oil production has remained relatively stable. On the whole, there seems to be an increasing trend towards the production of cash crops despite many constraints, the major one being the above-mentioned problem of access to customary lands, lack of fertilizer and other inputs (when fertilizers are made available to farmers, 60 to 70 per cent of farmers use them) as well as inadequate use of effective cropping technology (efforts are being made through a Smallholder Development Programme to revitalize such activities).

Table 1

Production of major products in agricultural, fishery and forestry sectors, 1985-1991

Commodity	1985	1986	1987	1988	1989	1990	1991
Copra (tons)	41,907	31,672	27,148	29,272	33,691	34,306	25,113
Coconut oil (tons)	-	-	-	-	21	21,693	2,717
Palm oil (tons)	20,000	14,560	11,999	15,227	20,091	22,104	22,518
Palm kernel (tons)	4,177	3,133	2,432	3,172	4,476	5,050	4,992
Rice (tons)	5,954	2,355	-	-	-	-	-
Cocoa (tons)	1,713	1,874	2,667	2,639	3,299	3,895	4,614
Fish catch (tons)	31,106	44,207	32,408	41,913	36,947	25,986	42,714
Cattle slaughter (no.)	1,666	1,820	1,640	1,354	921	410	295
Logs ('000m3)	378	471	322	310	304	436	245

Source: Statistics Division, Ministry of Finance, Solomon Islands, 1993.

17. A significant potential exists for the development of mining: about 80 per cent of the country's lands have been geologically mapped and resources of gold, bauxite, copper, nickel and phosphate have been discovered. However, there is currently very little activity in the mining sector apart from small-scale production of gold by locals (under 50 kg in 1990) and prospecting activities under licence for nickel. The overall level of prospecting has been declining in recent years, mainly on account of uncertainty about access to customary lands and related concerns about events in Bougainvillaea, in neighbouring Papua New Guinea, where land disputes around a large copper mine mushroomed into a secessionist war. The Australian and American holders of the mining prospecting company ARIMCO recently decided to discontinue their major gold exploration project at Gold Ridge, claiming inability to come to terms with the requirements of community land owners as the main constraint.

18. Most of the country's land area of 2.83 million hectares is covered by forests of which 254,000 hectares is commercially exploitable using available technology. The forestry sector is dominated by a dozen overseas logging companies, mainly from East Asian countries and Australia, which export logs and a limited amount of timber primarily to markets in Japan and the Republic of Korea. Commercial logging is one of the two largest sources[6] of foreign exchange and brings considerable revenues to the national exchequer, though the effective rate of tax collection is low. Because of the lack of effective reafforestation programmes, little replanting is taking place and it is estimated that at the present large scale of exploitation, the resources of commercially viable forests will be exhausted within twenty years.[7] Other major problems in the forestry sector consist of ineffective policing of logging methods so as to minimize environmental damage, ineffective participation by resource owners in exploitation, lack of control of logging company exports and of the grading of logged timber.

19. Given the expanse of some 600 km² of oceans, reefs and atolls, it is not surprising that fish and other marine products constitute an important export item and a major source of protein for the population of the Solomon Islands. Marine resources are well in excess of current commercial exploitation which started only in the 1970s. Since that time fish and fish products have become the dominant export earner for Solomon Islands, particularly tuna which is exported as either frozen, smoked or canned. By contrast, reef and shark fishing remains mainly artisanal and has tended to decline despite government efforts to provide up to 20 fish-processing facilities with the aid of Japanese and USAID funds. All commercial tuna fishing by domestic-based fleets is done by three large fishing companies. The largest of them, Solomon Taiyo (STL), is a joint venture between the central Government and a Japanese company, Taiyo Fishery; the second by volume of operations, National Fisheries Development Corporation (NFD), is a former public company which was sold in 1990 to the Canadian food conglomerate, BC Packers (BCP); the third, Makirabelle (MB), is a recent joint venture between a provincial government and a Philippine fishing company. The practice of concluding joint venture agreements between provincial governments and foreign entrepreneurs was further extended in 1992.

20. As tropical forests and fishery resources are the country's two most important economic generators with inherent comparative advantage and considerable potential for economic growth, export earnings and government revenues, these two sectors are expected to be the main basis for the development of diversification-related activities in the near future.

B. Major trends in commodity exports

21. Almost all production of cash commodities in the Solomon Islands is exported with the exception of sawn timber, a part of which is used for domestic construction. Since independence in 1978, the country has achieved a moderate diversification of export income; its structure has varied significantly over the years, reflecting fluctuations in both export prices and volumes of production. Table 2 summarizes important recent changes in the structure of commodity exports of the Solomon Islands. It reveals that export receipts remained concentrated on the two leading sectors - forestry and fishery, whose individual export shares were quite volatile.

22. Exports of forestry products generally follow the cyclical variations of the log market, where peaks are followed by a market slump and then by a build-up during the intervening years until a new peak is reached. The fall in log production and exports in 1991 was owing mainly to temporary corporate financial problems, which interrupted several of the larger logging operations. The subsequent apparent surge in log exports arose primarily from higher log prices in 1992 and the policies of logging companies, which tried to get logs out of the country as fast as possible in anticipation of lower prices in the future. Despite an increase in value of processed products, their share in forestry exports remains quite small.

23. Revenues from fishery sector exports are strongly influenced by variations in production volumes owing to seasonal factors. Their drop in the 1992 season can be explained primarily by the negative effect of a cyclone, which resulted in much lower catch rates for tuna. Table 2 also clearly shows a gradual increase in the share of processed fish products which, despite high variations of export volumes, are becoming an important part of fishery exports.

Table 2 A

Exports by sector composition, 1980 and 1985-1992

(Value SI$'000)

Sector	1980	1985	1986	1987	1988	1989	1990	1991	1992
Timber									
- Round log	14,882	23,709	33,953	35,067	37,607	38,783	55,526	49,455	104,021
- Sawnwood	1,081	1,035	1,774	2,106	2,182	2,539	4,285	4,102	6,434
Sub-Total	15,963	24,744	35,727	37,173	39,789	41,322	59,811	53,557	110,455
Fish									
- Frozen/smoked	20,538	28,389	48,123	47,466	69,427	56,238	34,782	69,760	57,194
- Canned	2,641	3,566	4,805	7,114	8,976	9,055	18,403	35,957	36,756
Sub-Total	23,179	31,955	52,928	54,580	78,403	65,293	53,185	105,717	93,950
Copra	10,515	23,471	5,951	8,328	15,656	20,974	10,936	10,369	19,805
Coconut oil	0	0	0	0	0	0	2,467	1,886	4,049
Palm Oil	6,650	12,382	5,611	6,902	12,344	18,200	17,933	16,340	31,996
Palm Kernel	386	1,365	412	726	1,661	1,871	1,387	1,384	1,868
Cocoa	637	5,009	6,472	9,198	7,445	7,935	11,051	13,456	13,232
Marine Shells	326	877	1,201	2,528	4,446	5,600	6,305	2,719	1,476
Gold	595	800	2,219	2,098	1,505	1,105	1,198	1,252	843
Other*	3,026	3,206	4,378	6,765	9,325	8,958	12,159	19,091	25,937
Total	61,277	103,809	114,899	128,298	170,574	171,258	176,432	225,777	303,611

Table 2 B

Exports by sector composition, 1980 and 1985-1992

Percentage distribution (%)

Sector	1980	1985	1986	1987	1988	1989	1990	1991	1992
Timber									
- Round log	24.3	22.8	29.6	27.3	22.0	22.6	31.4	21.9	34.3
- Sawnwood	1.8	1.0	1.5	1.6	1.3	1.5	2.5	1.8	2.1
Sub-Total	26.1	23.8	31.1	29.0	23.3	24.1	33.9	23.7	36.4
Fish									
- Frozen/smoked	33.5	27.3	41.9	37.0	40.7	32.8	19.6	30.9	18.8
- Canned	4.3	3.4	4.2	5.5	5.3	5.3	10.5	15.9	12.1
Sub-Total	37.8	30.8	46.1	42.5	46.0	38.1	30.1	46.8	30.9
Copra	17.2	22.6	5.2	6.5	9.2	12.2	6.2	4.6	6.5
Coconut oil	0.0	0.0	0.0	0.0	0.0	0.0	1.4	0.8	1.3
Palm Oil	10.9	11.9	4.9	5.4	7.2	10.6	10.2	7.2	10.6
Palm Kernel	0.6	1.3	0.4	0.6	1.0	1.1	0.8	0.6	0.6
Cocoa	1.0	4.8	5.6	7.2	4.4	4.6	6.2	6.0	4.3
Marine Shells	0.5	0.8	1.0	2.0	2.6	3.3	3.6	1.2	0.5
Gold	1.0	0.8	1.9	1.6	0.9	0.6	0.7	0.6	0.3
Other*/	4.9	3.1	3.8	5.3	5.5	5.2	6.9	8.5	8.6
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Solomon Islands.

Note: */ Including re-exports.

24. The share of the traditional export crop, copra, has been reduced in the total value of exports from 5 to 7 per cent, while some processing of copra into coconut oil has started. However, it should be noted that the mid-1980s was an exceptional period for this crop when the prices per ton of copra rose from $US 285 in 1983 to $US 601 in 1984 then dropped to $US 364 in 1985. In 1986 it fell more sharply, to $US 105 per ton while the export volume also fell (to 32,400 tons from 43,500 tons in 1985)[8] mainly as a result of the devastation caused by cyclone Namu. In 1990, copra prices fell again significantly. This, combined with increased competition on the world market from other producers of copra and similar oils and oilseeds, has negatively affected Solomon Islands export revenues. The unattractiveness of copra production at prevailing prices was the main reason for its sharp decline in 1991, which was mostly accounted for by a reduction in production by smallholders. The value of exports of the two other most important agricultural products - palm oil and cocoa - were also largely affected by fluctuations in international prices.

25. As far as the direction of trade is concerned, Japan and the Republic of Korea account for most of the fishery and forestry sector exports of the Solomon Islands, while trade with the European Union takes all the cocoa and most of the palm oil. Australia imports most of the sawn timber but apart from this, very little is exported to this country. As can be seen from annex I, Japan remains the main destination of the country's exports, closely followed by the EEC and Asian countries. After Australia, Japan is the second largest origin of import flows to the Solomon Islands.

26. The Solomon Islands, classified as a least developed country and being covered by Lomé conventions and the SPARTECA[9] agreement, benefits from very few restrictions on exports of commodities to all major markets as well as from regional concessions. However, apart from exports of canned tuna to other Pacific island countries (mainly to Fiji) as well as imports of red meat from Vanuatu and coffee from Papua New Guinea, there is only limited interregional trade with neighbouring countries because of the low complementarity of their resource bases. The major prospective markets for export commodities (primarily for fishery and forestry products) are located in the Pacific rim countries including Australia, New Zealand, South East Asian countries, Japan, Republic of Korea and, for some products, the United States of America.

Chapter II

MACROECONOMIC ENVIRONMENT AND GOVERNMENT POLICIES AND MEASURES AFFECTING COMMODITY-RELATED DIVERSIFICATION

A. General economic environment

27. The Solomon Islands remains by and large a traditional Pacific village economy with the principal economic activities consisting of or related to the production of primary commodities. Commodity processing consists mainly of fish canning, saw-milling, palm oil and coconut oil processing. Industrial production is very limited and involves mainly the manufacturing of buttons (from Trochus shells), boat building (mainly fibreglass for village fishermen) and two clothing manufacturers. The tourism industry is still at its infant stage of development. Not surprisingly, economic performance of the country and its general economic policy environment have been associated primarily with commodity-related activities.

28. The *Central Bank Annual Report 1991* described the Solomon Islands economy as simply "running on the spot"[10] with modest economic growth in relation to potential and an unsustainable level of debt financing, accompanied by an unstable economic and political environment. The shortage of liquidity is accompanied by high interest rates, maintained also in order to reduce pressure for further devaluation of the Solomon Islands dollar, which had been gradually losing its value (US$/SI$ average rate was at the level of 0.83 in 1980, 2.53 in 1990 and 2.93 in 1993)."

29. This gradual devaluation, however, has not significantly stimulated diversification or growth of export earnings. The maintenance of high interest rates has not been conducive to increasing private sector investment in export industries.

30. The relatively narrow base of economic activity, coupled with limited domestic savings potential, contributes to the scarcity of local capital, a very low level of domestic investment and increasing use of external loans by the private sector. The Government has limited experience with using accumulated savings for the needs of private investors and the major source of private funds remains the three principal commercial banks which are either wholly owned or co-owned by Australian banks and which account for more than 80 per cent of commercial lending. The rest of commercial lending capital is provided by the public statutory authority - the Development Bank of the Solomon Islands (DBSI), the Small Business Finance Scheme (SBFS) and credit unions.

31. The Solomon Islands financial system has worked relatively better for the Government, larger private enterprises and foreign investors than it for smaller private businesses which are short of equity and already at a disadvantage regarding the acquisition of foreign capital; and it has virtually not assisted individual commodity producers at village level. Assistance to medium and small-scale entrepreneurs is provided through the SBFS; this is limited to loans of up to $SI 100,000 and is applicable only to indigenous entrepreneurs starting up new business or expanding their activities mainly in rural areas. These loans have been used, for example, to finance purchases of outboard powered fibreglass boats and chain saws. A relatively important source of assistance to smallholders in the agricultural sector, although not directly credit-related, is the Lomé III smallholder development project, which is concerned with diversification and intensification of smallholder production activities.

32. Like most commodity-dependent countries with limited financial resources and difficulties in attracting foreign private capital, the Solomon Islands relies heavily on financial and technical support from the international development assistance community. Since independence in 1978, the country's

development has been heavily influenced by the attitude of aid specialists who were focused on the idea that development was only a few million dollars away and could be achieved by means of another Asian Development Bank (ADB) project loan, STABEX transfer or JICA grant. This has developed in the country a sort of "aid culture", which assumes that the benefits of development assistance and royalties from licence holders in forestry and fishery would "trickle down" to increase the welfare of the indigenous population.

33. Information about the sources and extent of government borrowing is given in annex II. It shows that by 1993 accumulated borrowing from international agencies (ADB and the World Bank), all of which was on concessional terms, accounted for nearly 60 per cent of total external loans. The structure of loans provided by ADB, the main international donor, is shown in annex III. The major part of financial and technical assistance of the ADB as well as of that coming from other donors, was earmarked for the development of infrastructure and commodity-related activities.

34. Over the last few years the EEC/EU was the largest bilateral donor to the Solomon Islands. Technical support under the Lomé conventions has been provided through commitments under a series of National Indicative Programmes, while financial support has been given through STABEX transfers in compensation for losses in earnings from exports of specific commodities. Some commodity-related diversification activities have been financed through lines of credit. For instance, credit lines from EDF and EIB have been channelled through DBSI, in order to provide loans to local private sectors for investing, among others, in downstream processing of primary products.

35. During 1991-1992, the Government held several consultations with the IMF, World Bank and donor countries on structural reforms. There is now recognition that a cohesive package of structural measures should be implemented in the country in order to overcome a chronic fiscal drift. So far, however, no agreement has been reached on comprehensive structural adjustment reform. As a result, economic management and exchange rate policies suffer from a lack of coherent income, investment, fiscal and monetary policies.

B. Government policies and activities affecting diversification

36. Although the economy of the Solomon Islands has always been a fundamentally free market one, the country has a relatively large public sector. Owing to a general reluctance on the part of foreign private investors to get involved in economic activities in the Solomon Islands, caused mainly by the uncertainty surrounding the local economic environment, the Government began to take an active role in investment activities with a view to attracting foreign capital to participate in national economic development through joint ventures. This policy has led to the establishment of a number of joint ventures and the creation of employment opportunities, but it has not resulted in the return on investment as expected. As a consequence, the Government is now attempting to opt out of these ventures and to encourage their privatization by granting attractive incentives to foreign investors.

37. The Government participates in private sector investment projects through the Investment Corporation of the Solomon Islands (ICSI), which holds equity in DBSI and in a number of joint ventures with private companies. The Government has taken, through ICSI, an active equity interest in several large-scale commodity-related ventures operating directly in specific commodity areas. Table 3 illustrates this participation.

38. The returns on funds of ICSI parastatals, as well as of other public enterprises[12] have been poor. These enterprises have regularly required the allocation of substantial subsidies from the government budget. Of the venture arrangements in specific commodity-related areas listed in table 3, only LSL has made a positive contribution to the Government through an annual dividend.

Table 3

Equity participation of the government in the major specific commodity-related enterprises (as at end of 1992)

Company [Foreign Partner]	Percentage of Government participation	Major activity	Assets ($SI million)
SOLOMON TAIYO LTD (STL) [Tayio Fishery Company]	51	TUNA FISHING/ CANNING/FISHMEAL	104.5
KOLOMBANGARA FOREST PRODUCTS LTD (KFPL) [Commonwealth Development Corporation]	50	REAFFORESTATION	16.8
LEVER SOLOMON LTD (LSL) [Unilever]	40	COPRA/COCONUT OIL/COCOA	26.6
SOLOMON ISLANDS PLANTATIONS LTD (SIPL) [Commonwealth Development Corporation]	40	PALM OIL/COCOA	45.4

Source: Investment Corporation of the Solomon Islands, 1993.

39. The Government has embarked on a programme aimed at reducing the size of the public sector from the late 1980s. It is currently envisaging privatization of all the holdings of the ICSI. The Government has already sold the National Fisheries Development Corporation to BC Packers, its equity share in the National Bank of Solomon Islands to National Provident Fund and its share holding in the Mendana Hotel. It is also encouraging parastatals to divest non-performing assets and is cutting the amount of subsidized credit. The main problems associated with the Government relinquishing interest in these venture arrangements are the absence of buyers willing to pay a price that would allow the Government to recover its initial investment. Moreover, asset disposal seems to be on an *ad hoc* basis, with the absence of a general policy on privatization and commercialization of public equity in commercial ventures. The lack of a coherent plan of asset rationalization and divestment has already created additional financial problems for ICSI.

40. Together with attempts to reduce the role of public enterprises, the Government is actively putting emphasis on the growth and development of the private sector in the Solomon Islands. It welcomes foreign private investments as a means of increasing economic activity, widening the resource base of the economy and strengthening technical, marketing and productive expertise. In relation to the development of private initiative in the export sector, involving almost entirely commodity-related activities, government assistance has consisted mainly of the provision of investment incentives, with relatively less attention paid to the development of support services, either directly or by means of fostering the private sector's potential to provide these services.

41. The current foreign investment policy does not specify any minimum level of local capital participation. In order to implement this policy, the Government has established a Foreign Investment Board (FIB) which evaluates and approves foreign investment proposals, obtains relevant information from ministries and provincial authorities and is designed to simplify bureaucratic procedures by providing a one-stop shop for potential foreign investors.

42. The Government has also established a set of guidelines for assessing the economic net benefit of any investment to the economy of the Solomon Islands. These guidelines provide the investor with information concerning the extent and form of investment incentives which a project could attract. They fall into two

main categories: taxation incentives; and, import and export tariff exemptions. Taxation incentives consist of very generous tax holidays and provision for accelerated depreciation. In order to encourage export-oriented activities, a 150 per cent tax deduction is granted on all expenditures incurred in export market development and promotion. Export tariffs are levied only on a few products and are designed to favour exports of processed commodities. Every project in excess of $SI 10 million and approved by the FIB is exempted from tariffs on all imported machinery and materials used in the project. This measure, however, penalizes exporters of traditional products who are subject to high duties on imported inputs. Although the main criterion for project approval is its net economic benefit to the economy of the Solomon Islands, the Government has indicated priority areas where foreign investment is particularly welcomed. More detailed information on priority sectors and investment incentives is contained in annex IV.

43. Although the foreign investment code and regulatory framework are very liberal and were elaborated in line with government policy to encourage greater value added through increased commodity processing, investment incentives are biased in favour of large, foreign-financed projects and do not provide adequate stimulus for small-scale domestic enterprises. Moreover, provision of these incentives contributes to the deficiency of budget revenues, while the selection of beneficiary sectors is very general and has failed to avoid artificial stimulation of inefficient exports to the detriment of existing and potential opportunities of other export products. These incentives may also negatively affect the country's export interests in case of accusation, in particular in the GATT, of unfair competition by competing or importing countries. Furthermore, it is also clear that the investment promotion package can have a rather limited effect on the decision of potential investors if macroeconomic and political problems are allowed to continue.[14] Evidence from other developing countries suggests that a favourable macroeconomic and political environment coupled with supportive government measures in the areas of infrastructure, training, research and development, information, etc., can contribute more to encouraging private investments in diversification-related activities than does the provision of tax holidays and other investment incentives.

44. The lack of adequate infrastructural support provided by the government and financed from budget funds and (mainly) foreign assistance sources constitutes a major constraint on the development and diversification of commodity-related activities. Relatively heavy investment in the development of the national transportation network, which constituted the largest area of public investment during the past decade,[14] did not solve the problem of transport bottlenecks. This problem is particularly acute in a country with population scattered across scores of islands. The high cost of transport, related to a widely dispersed territory, hinders the development and diversification of the national economy. The problem is aggravated by the increasing need for rehabilitation and maintenance activities, which are particularly inadequate in the land transportation area[15] and depend almost completely on external funding sources.

45. The Solomon Islands Port Authority (SIPA) operates all the ports[16] in the country and provides all related services. With external financial and technical assistance, major efforts are currently underway to upgrade the Honiara port facilities and to improve SIPA operations. The operation of the parastatal Solomon Islands Airlines, providing both domestic and international air transportation services,[17] is highly dependent on government assistance: in 1992 subsidies to this company accounted for more than a half of all central government transfers to parastatals. Through the Solomon Islands Electric Authority, the Government is implementing a policy of cross-subsidization of tariffs for electric power, which envisages that consumers in Honiara subsidize the higher costs of power generation units at remote stations, supplying, in particular, commodity producing and processing enterprises.

46. Research and development activities in various commodity sectors are financed mainly by donor agencies with some local counterpart funding. The main projects which impact on commodity-related activities are outlined in table 4. Although the development of research and extension services has recently been strengthened within the framework of the relatively important Rural Support Project and Smallholder Development Project, difficulties persist. This primarily concerns inadequate research in areas of adaptation and development of new technologies and varieties of export products and in the delivery of public extension services. The development of research efforts in these and other areas continues to be hampered by the lack of adequate staff, facilities, training programmes and financial resources.

Table 4

Research projects by sector

Sector	Projects	Agency	Year started	Total cost US$ million
Agriculture	Rural Services	SIG/ADB/IFAD	1984	12.76
	Small holder Dev.	EDF/STABEX	1988	3.00*/
	Rural Transport	EDF/STABEX	1988	2.50
	Rural Financial Services	IFAD	1991	2.50
Fishery	Rural Fishing Enterprises	JICA/EDF/CAN	1989	2.00
	ICLARM-Giant Clam	IDA	1988	1.50
Forestry	Forest Inventory Survey	AIDAB	1990	3.78
	Forest Regeneration	EDF/NZ	1991	1.00
Business	CEMA Trade & Marketing	EDF/STABEX	1989	1.00
	Special Projects (MCPI)	UNIDO	1989	0.47
	Food Processing Entrepreneur Dev.	NZ	1990	0.10

Source: Estimates on the basis of information provided by different ministries of the Solomon Islands.

Note: */ ECU.

47. The area of marketing of non-traditional commodities could benefit from more attention by the Government; while marketing facilities are far from adequate in most regions of the country. Very little is done in the area of trade promotion other than the provision of a Government officer in charge of this problem in the Solomon Islands consulate in Brisbane (Australia). There is no regular market information or price reporting system which exporters could use for their own benefit: most export marketing information is in the hands of foreign private dealers and enterprises. Moreover, no government measures have been elaborated to ensure the maintenance and upgrading of product quality in accordance with requirements of international markets. Not surprisingly, the lack of market information and the absence of direct export marketing links poses problems in attempts to diversify the export base. In order to become competitive in international markets, non-traditional exports from the Solomon Islands require strong government support in the marketing field. This could be achieved by provision of specific support services by the Government either directly or by means of encouragement and coordination of private sector efforts to provide these services, or by a combination of both.

48. With the exception of copra, all exports of major products-palm oil and kernel, coconut oil, tuna, lumber and wood products - are handled by multinational corporations, while only 7 per cent of the total value of export

trade is handled by statutory marketing authorities, mainly confined to copra exports. The major statutory authority operating in the area of marketing,[18] the Commodities Export Marketing Authority (CEMA), was established in 1985 to redress the shortcomings of its predecessor, the Copra Board. CEMA has a monopoly on all exports of copra from Solomon Islands and also manages a copra price stabilization scheme which has operated since the inception of the Copra Board in 1953.[19] It operates eight buying centres, which are fed by 25 depots or local overseas buyers. CEMA specifies three grades of copra and pays a differential to encourage higher quality. CEMA also controls exports of cocoa and has recently started to purchase ngali nuts, chilies and tiny amounts of other spices through its buying centres. It is also involved in a number of development projects concerning spices, coffee and ngali nuts. It has sponsored a programme of trade-promoting visits for copra and cocoa. There has also been a recent USAID-funded marketing visit for export of ngali nuts to the USA.

Chapter III

EXPERIENCES WITH INDIVIDUAL COMMODITIES

A. Forestry

49. With the evidence of a non-sustainable level of exploitation of the natural timber rain forests in the Solomon Islands, the Government is not stimulating production growth in the forestry sector, but has to deal with the problem of how to maximize returns from exploitation of the fragile forest resources, which contribute considerably to budget revenues and foreign exchange earnings. This is one of the main development issues facing the country.

50. Foreign companies operate in the forestry sector through logging licences backed by regulations and restrictions on the methods of felling and extracting trees. The application of these regulations, however, encounters serious problems as it is very difficult to control operations once they have commenced. Current logging licences attempt to regulate the flow of round logs and sawn log off-take through the following measures: annual logging quotas, fixed percentage of sawn/round log off-take and higher export tariffs on round logs at the level of 30 per cent on FOB prices plus a 7.5 per cent reforestation levy. The aim of introducing this package of measures was three-fold: to ensure a higher level of value added in the domestic timber industry; to limit round log exports; and, to contribute to budget revenues. However, mainly because of the lack of appropriate safeguards and enforcement, none of these targets has been achieved. The regulations have been largely ineffective in limiting round log exports and have failed to increase exports of sawn logs or raise government revenues.

51. The imposition of statutory requirements for logging licences, which envisaged the minimum amount for sawn timber off-take at a level of 20 per cent (this level was recently raised to 40 per cent), has been ineffective in stemming the rate of round log exports.[20] The unresolved issue of customary land ownership and the by-passing of central government authorities by logging companies which choose instead to deal directly with local landowners or provincial administrations, have exacerbated this failure. Given this state of affairs, an obvious policy response could be imposition of a ban on all round log exports coupled with authorization of only sawn timber exports. The current situation, however, does not seem to favour the introduction of such a measure as it could have a serious impact, at least in the short term, on government revenues from exports of round logs.

52. Attempts were also made to promote an increase of the value of timber exports by using tax incentives (timber products benefit from incentives envisaged under the Foreign Investment Act), subsidies to domestic mills and provision of portable saw mills and chainsaws. These measures, for their part, have not contributed significantly to the improvement of the situation in the wood processing sector: at present there are about 70 licensed sawmills in the country, of which fewer than 20 are operational, while four alone contribute more than 75 per cent of the volume of sawn timber produced. All sawmills need rehabilitation and renovation.

53. The lack of success in the promotion of local processing of wood is largely due to low efficiency in production, the inadequate quality of wood products and their resulting low competitiveness on international markets. The situation is complicated by the fact that the natural rainforest in the Solomon Islands is not homogeneous, but "mixed", thus creating additional problems for a wood processing facility which requires a regular supply of uniform timber.

54. Despite some positive results with attempts to export small amounts of processed "eco-timber"[21] to niche markets, in most other cases export experiences were less successful: the operational costs of local mills have proved to be higher than of those in developed countries, and the quality and reliability of

their supplies less stable. The across-the-board provision of additional substantial investment incentives to these enterprises (as opposed to the case-by-case evaluation approach) can be counter-productive as it may lead to an artificial stimulation of their exports and, thereby, to the locking-in of their inefficiency. Conversely, appropriate direct and indirect government supportive measures, in particular in the areas of training, research and development (primarily technology transfer and adaptation) and marketing, could contribute to increasing efficiency in the timber processing sector.

55. There is no standardized framework for logging licence agreements, which involves various royalties, taxes and fees the amount of which is negotiated on a case-by-case basis. This practice, accompanied by a relatively high level of nominal taxation and lack of strict governmental control, allows foreign operators to avoid taxation by large-scale use of transfer prices and under-reporting volumes of exports. Evidence suggests a general underpricing of logs exported from the Solomon Islands relative to normal FOB pricing of similar species in the region.[22] This, in turn, reduces significantly the level of actual tax benefits accruing to the Government. The recent creation of the Timber Control Unit within the Ministry of Natural Resources did not improve the situation much because of the limited staff of this institution, established to police the activities of logging companies. The review of tax policies in the forestry sector may contribute to an increase of government revenues through the introduction and efficient implementation of simplified, standardized taxation and better compliance with appropriate forest-resources exploitation practices by logging companies.

56. Under the present tax rules, logging companies may opt to pay a 7.5 per cent reforestation levy or to undertake their own replanting programmes. The majority of the companies choose to pay the levy. As a result, despite the rapid deterioration of forest resources, little reforestation is actually taking place in the country; replanting programmes receive very little government support. There is also an evident lack of trained rangers to minimize environmental damage by ensuring compliance with established regulations in respect of the activities of logging companies, particularly the use of improper cutting methods.

57. The reforestation efforts to date have been concentrated on government land, which comprises approximately 9 per cent of the territory of the country. Apart from the Kolombangara project, under which about 1,000 hectares were planted in 1991 with the assistance of the Commonwealth Development Corporation (CDC), commercial replanting activities have been very limited. Moreover, the parastatal involved in reafforestation (Kolombangara Forest Products), had major financial problems and was operating on loan funds from CDC as the Government equity requirements have not been fulfilled. At the same time, the role seems to be underestimated of natural regeneration of tropical forests, which in the case of the Solomon Islands and many other developing countries may prove to be a more efficient way of preserving national forest resources than large-scale reforestation programmes.

58. In order to reduce logging rates, the Government has recently attempted to halt the issuance of new logging licences. This measure, however, may have only limited success as, taking into account budget considerations, prospects seem limited for its successful contribution for a relatively long period. Envisaged projects of transferring the issuance of new licences to provincial authorities could lead to the undermining of government regulatory policies and accelerate depletion of national forest resources.

59. The lack of an adequate public, or government-supported private, quality-control system undermines export prospects for traditional and non-traditional products and leads to revenue losses of both the Government and customary landowners. Undersizing of logs has been often reported as well as poor quality of sawn wood caused mainly by inappropriate kiln drying. Evidence also suggests considerable disadvantages of the currently used practice of "mixed" exports of lumber from the Solomon Islands, when often less than a half the exports are utilised in subsequent higher technology processing in importing countries. The

balance is used as low-value processing or packing grade wood. The establishment of a proper tree selection and post-harvest treatment systems, including, in particular, round log grading in order to meet prescribed requirements of specific markets (primarily in Japan and the Republic of Korea) could contribute significantly to the reduction of the current disturbingly rapid rate of commercial logging.

60. In order to reduce post harvest losses of lumber, infrastructural facilities need improvement and upgrading, especially if opportunities for an increase in sawn timber supplies, requiring specially equipped transportation means, are taken into consideration. Another problem is the lack of a regular market information system which exporters could use for their own benefit. In particular, timber prices are not disclosed by companies and it is difficult to obtain feedback on the use of local timber by overseas buyers.

B. Fishing

61. Fisheries represent the leading sector of national exports with most revenues earned from tuna. Offshore fishing is carried out by foreign vessels operating in the EEZ under licence as well as by three large tuna fishing and processing companies, of which Solomon Taiyo Ltd.(STL) accounts for nearly 80 per cent of total output. The company has a canning plant at Noro, which is a major employer and one of the principal sources of export products. Apart from revenues from licensing foreign fishing vessels, the Government derives relatively little from fishing activities, as the two major companies benefit from tax holidays and the third company usually reports very limited profits, while taxes on exported tuna are low. The 1992 season was one of the worst on record for the fishery sector, this being due to seasonal influences primarily related to weather disturbances.

62. The development of the fishing sector has made a major contribution to the diversification of the national economy and exports. This has been achieved, however, at a relatively high cost in terms of the amount of public resources spent. The latter was owing, in particular, to the disappointing performance, and sale at a heavy loss, of the public National Fisheries Development Authority (NFD) as well as to inadequate returns on the investment in the STL. Although, in 1990, the NFD was sold and is actually operated by a Canadian company, BC Packers, the Government still bears debt commitments related to this venture. As far as government participation in the STL is concerned, the company does not pay any dividend to the Government. The Government is now seeking ways of divesting its share in STL in order to let it operate as a private company paying taxes, duties and acquiring fishing licences.

63. At the same time, the development of STL-controlled fish canning and fish meal processing activities at Noro was quite successful. The Japanese Government has invested around $US 18 million in port facilities and infrastructure at Noro, which is the focus of the fish canning enterprise. The success of this venture has been primarily owing to the ability of the company to market the canned tuna abroad at a very attractive price. It has also introduced a range of new product lines, including that of special sorts of tuna, which are being increasingly accepted in many South Asian markets.

64. Efforts to diversify away from tuna have concentrated on the development of reef fishing activities, which remain a village operation with processing at nine fishing centres and eleven depots or sub-centres established with the assistance of Japanese aid funds in the mid-1980s. Each centre had refrigeration rooms and ice-making facilities and each depot provides ice for local fishermen. However, all these centres remained under-utilized (or idle) and all need rehabilitation with the exception of three centres in Tatamba, Marau and Yandina, which had been rehabilitated after February 1991 under an EDF-sponsored project. This project has facilitated the rebuilding of jetties, repairing equipment for ice-making and providing boats for family-firm fishing. The effort needs to be

supplemented, however, by an export-oriented commercial reef fish processor who could purchase and further process fish for the Australian and subsequently South-east Asian markets.

65. The failure of local fishermen to increase their returns through the utilization of fishing centres was owing mainly to the lack of private commercial export-oriented involvement from the start, as well as to the lack of regular access to and knowledge of export markets. Moreover, because of the lack of recurrent funding from provincial authorities, the facilities of the centres have not been adequately maintained. Other problems were lack of continuous supply, inadequate handling and presentation of the product, and high domestic and overseas transportation costs. There is a clear need to institute export standards for reef fish to ensure that undersized and uneconomic species are not caught for export and that fish is processed in accordance with export market requirements.

66. As regards infrastructure, the development of reef fish export activities clearly suffers from the lack of means of transportation to a central point of assembly and further processing, which is envisaged in Honiara. There is also a need to provide improved line and tackle, larger motor power launches for processing and cold storage facilities in Honiara for holding reef fish destined for export in containers. The commercial development and operational efficiency of these facilities in Honiara is, however, constrained by the SIEA policy which maintains high tariffs on electricity and does not allow installation of any privately owned electric power generation equipment within the Honiara area. Exports of reef fish by air are hampered by the high freight rates of the national airline.

67. Problems and prospects of developing reef fishing activities were discussed during the round table meeting between representatives of relevant international organizations and the Solomon Islands, which was held at the end of 1993 within the framework of the UNCTAD-coordinated pilot project on commodity processing for selected developing countries. The meeting identified an integrated diversification project involving reef fishing production, processing and marketing activities and indicated the support commitments needed with a view to establishing a joint venture enterprise, which might eventually be involved in processing and exports of other commodities. The project proposal is at the stage of its finalization with interested private investors taking duly into account the maintenance of the sustainability of the fishery resource and of creating an enterprise through which long-term benefits will accrue to the Solomon Islands participants.

C. Other commodities

68. There are a few interesting diversification experiences with other commodities, including the processing of traditional export items (copra), non-traditional export-oriented primary commodities (cocoa), new products with both domestic and export market potential (honey) as well as commodities oriented to satisfying internal demand (livestock).

1. Copra and coconut oil

69. Although from the world market perspective the Solomon Islands is considered as a minor producer and exporter of coconuts, the coconut sector has traditionally played a very important role in the country. Coconuts continue to be widely produced despite the fact that copra as a traditional export commodity does not offer much prospect for long-term growth.

70. The maintenance of copra prices is provided through the CEMA's copra price stabilization scheme which, in case of depletion of its reserves, is supported by allocations from the Government. Despite recent moderately favourable changes

in international copra prices, it seems unlikely that the copra industry could continue to rely on budget transfers originating from taxes on exports of other commodities.

71. The largest producer of copra - Lever Solomon (LSL) - has diversified out of copra into processed products by building a small mill in 1989 and since then exporting small quantities of coconut oil. The construction of this mill was financed by a loan from CEMA. After construction, the plant operated below its expected level, mainly because of technical problems and low demand for its products, while doubts were expressed about its future in view of a reduction in the availability of coconuts for processing. In 1992, the Government provided a significant loan to LSL in order to keep the plant operational.

2. Cocoa

72. Diversification into cocoa production started in the 1960s and was undertaken mainly without government assistance - neither government-sponsored cocoa growing programmes nor public marketing or extension services were provided. The bulk of cocoa was produced by two major joint ventures between the Government and transnational corporations (LSL and SPL), using their own marketing channels. The share of plantations has diminished to about 40 per cent of cocoa production in 1992, reflecting the growing interest of smallholders, who were encouraged by cocoa planting and rehabilitation activities under the Smallholder Development Project. Smallholders started to switch to cocoa production mainly after 1987 when the Government started to regulate exports by a system of licences, providing smallholders with a certain consistency in purchases of their crops. CEMA is now moving towards being a supervisory agency for both domestic prices and export quality. Additional government resources may be required to finance the development of cocoa marketing and grading systems.

3. Honey

73. A rapid expansion of honey production since 1989 under the impetus of a New Zealand-funded project to promote bee-keeping by rural households may be considered an example of a successful diversification effort. This innovative project was undertaken with very little government involvement. It was successful mainly on account of the establishment of an independent professionally managed bee cooperative, undertaking both production and commercial marketing. The project required minimal capital and technology inputs, very low import content, and was flexible in respect of the production unit size. It was successful in finding an export market because of the excellent quality of honey produced. However, this smallholder industry faltered in 1992 when technical support was interrupted and high producer prices resulted in marketing problems and accumulation of stocks. Pricing and marketing need special attention, especially taking into account the prospects of entering the Australian market (the honey has recently been given quarantine clearance in Australia which may provide a significant stimulus to local producers). The industry also has good prospects for diversifying into pollen and queen bee exports, exploiting the advantage of the unique disease-free status of local bees.

74. The situation in the honey industry was discussed during the above-mentioned round-table meeting, which identified a multi-product commercial project and indicated commitments of international agencies and of the Solomon Islands Government to support its start-up. This project is being developed on the basis of a feasibility study on the further diversification of apiculture and it is envisaged that it should, to the extent possible, contribute to intensification of domestic investment and entrepreneurial capacity.

4. Livestock

75. An example of an unsuccessful attempt to change the face of the Solomon Islands agriculture sector is the experience with developments in livestock raising, which was supported by generous injections of bilateral and multilateral assistance with a view to developing cattle production by both smallholders and plantations. The institutional vehicle for the provision of development support was the statutory Livestock Development Authority (LDA), whose charter was adjusted during different phases of the assistance programme. Despite these adjustments, the national cattle herd had diminished from 25,000 of 27,000 in 1980 to less than 10,000 at the beginning of 1990s, while cattle slaughtering has dropped sharply since the mid-1980s. The national cattle industry appears to be shrinking back to a handful of community-owned or plantation herds, as smallholder cattle die or are killed. The LDA has become reconciled to this process and in early 1990s began to import beef from Vanuatu, while switching its attention to poultry and pig production.

76. Many reasons have been advanced for the failure of attempts to develop the livestock industry, given that cattle are raised successfully under similar conditions in Vanuatu. The major reason has apparently been the unattractive official buying prices for cattle, set by the LDA. There was also a factor of limited competition for marketing outlets, given the fact that there were very few private butchers in the country. As the cattle were raised by smallholders who mainly cultivated coconuts, the switching of many smallholders to cocoa production has somewhat reduced the area devoted to cattle. There was also a duplication of functions of LDA and the Ministry of Agriculture and Lands in the provision of support services to the livestock sector. This duplication not only increased the cost of the services, but also rendered them less efficient. Moreover, while government policy was devoted to increasing red meat production, Solomon Islanders continued to place more emphasis on pork and chicken production as they traditionally tend to favour these meats. Not surprisingly, the switching of LDA attention to poultry and pig production has led to better results - these sectors are showing signs of growth with the start of the LDA programme envisaging the distribution of improved stock and the purchase of smallholder output.

* * *

77. In sum, the development of a diversified range of economic and trade activities in the Solomon Islands has been constrained by a variety of binding factors. These range from an acute shortage of skilled and experienced human resources, inadequate infrastructure facilities and services, including those in the crucial areas of agricultural research and extension services, to a chronic shortage of domestic savings and financial resources. In addition, the persistence of macroeconomic imbalances has not been favourable either to the development of private entrepreneurship, or to production and trade diversification. The country's vulnerability to frequent natural disasters, cyclones in particular, constitutes another formidable barrier to development.

78. The Government has recently been paying special attention to the promotion of foreign direct investment especially in the development of non-traditional exports and it has put in place liberal investment legislation and incentives. Generally, however, the success of these measures has been relatively modest - not least because of the lack of complementary or auxiliary support services and resources; these are persistent in most small developing economies and would require much investment on a long-term basis.

Annex I

Direction of external trade of the Solomon Islands, 1985-1990

(Percentage)

Export destination	1985	1986	1987	1988	1989	1990
Japan	51.9	37.0	35.6	34.5	33.2	39.2
Australia	2.3	4.0	3.7	4.7	7.2	4.5
Pacific	2.5	5.1	6.8	11.9	6.9	5.8
Other Asia	11.1	33.1	21.6	22.2	20.1	14.2
European Union	29.5	17.5	22.3	21.4	27.8	31.9
United States of America	2.5	0.1	5.2	0.1	0.1	0.1
Other	0.2	3.2	4.8	5.2	4.7	4.3
Total	100.0	100.0	100.0	100.0	100.0	100.0
Import source	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**
Australia	37.2	40.0	41.4	45.5	36.1	35.3
Japan	19.6	16.9	19.1	16.2	23.3	16.2
New Zealand	9.0	7.7	7.9	8.3	7.7	9.3
European Union	6.3	6.9	7.3	8.1	4.8	4.7
Singapore	10.2	8.2	9.2	5.4	7.9	14.4
Other Asia	11.0	10.0	8.9	9.8	12.1	11.3
Other Pacific	4.2	4.5	3.3	4.6	5.6	5.7
Other	2.5	5.8	2.9	2.1	2.5	3.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: The Solomon Islands Economy: Prospects for stabilization and sustainable growth, IDP No. 21, AIDAB, Canberra, 1991.

Annex II

Source and extent of Government external borrowing

(as at end 1992)

Source	Amount Borrowed $SI million	Maturity Period (years)	Grace Period (years)	Interest rate %
ADB	101.3	40	10	1
CDC	4.7	16	-	10.25
EEC	29.3	40	10	1
Kuwait FAED	11.5	18	-	3
OPEC Fund	3.4	-5	3-5	0.5-5.0
United Kingdom	17.6	22 - 25	8	-
World Bank	57.2	50	10	0.75
Klochner/Hermes	7.1	10	-	9.50
EFIC (Australia)	25.3	10	-	7.20
EIB	0.1	6	-	2
IFAD	6.2	50	10	1
Marubeni Bank	4.5	7	2	.
TOTAL	268.0	.	.	.

Source: Central Bank of Solomon Islands, *Annual Report* 1992.

Annex III

Loans from Asian Development Bank

Loan No.	Project	Amount US$ million	Term, Years (Incl. grace period)	Date approved
289	Beef Cattle Development	3,570	40(10)	21 December 1976
311	Fisheries Development	3,600	40(10)	13 October 1977
323	Honiara Port Development	2,030	40(10)	9 December 1977
394	Dev. Bank of Solomon Islands	2,000	40(10)	19 April 1979
478	Honiara Water Supply	1,850	40(10)	30 October 1980
508	Dev. Bank of Solomon Islands	2,000	40(10)	22 December 1980
646/647	Agricultural Development	7,750	40(10)	27 October 1983
704	Guadalcanal Road Improvement	2,000	40(10)	6 November 1984
803	Power Expansion	4,210	40(10)	27 November 1986
832	Second Honiara Port	4,000	40(10)	4 June 1987
844	Second Fisheries Development	5,300	40(10)	29 September 1987
1064	Second Power Expansion	4,700	40(10)	11 December 1990

Source: ADB Bulletin.

Annex IV

MAIN FEATURES OF THE INVESTMENT POLICY: PRIORITY SECTORS AND INVESTMENT INCENTIVES

The Government has indicated areas of priority in which foreign investment is particularly welcomed. These priority sectors include:

(a) Assembly

Assembly of vehicles, motor vehicles, bicycles, radios, computers, office equipment, calculators and other electrical equipment.

(b) Manufacturing

The manufacture of garments, shoes, food items, wooden products, garden tools, building materials, components and spare parts.

(c) Processing

Processing of food and non-food products such as fish, root crops, drinks, vegetables, nuts, copra, cocoa, palm oil, marine products, veneer, plywood boards and mouldings.

(d) Tourism

Development of hotels of up to 300 rooms, island resorts up to 50 rooms and tourist-related activities such as cruising, dive tours, game fishing and other water sports and recreational pursuits.

(e) Transport

Building and manufacture of tourist vessels, cargo, passenger and fishing boats.

(f) Mining

Mining, prospecting and processing of marketable raw materials

(g) Services

Professional business services such as computer repairs, accounting and data processing facilities.

Specific sectors currently targeted by the Government for FDI include:

(a) Forestry

The Government welcomes investment in reforestation and commercial plantation development, saw-milling and processing of natural wood.

(b) Fisheries

The Government places priority on deep-sea fishing, reef fish exporting, marine farming and breeding for processing and export.

(c) Agriculture

The Government welcomes investment in commercial farming of root crops, nuts, fruits, bananas, pawpaws, melons, vegetables and other cash crops such as vanilla,uthrmeric, ginger, chili, coffee, tea and tobacco.

Incentive mechanisms

Incentives fall into two main categories:

(a) Taxation incentives and concessions;
(b) Import and export tariff exemptions.

Taxation concessions

Generally any foreign investment project approved by the Foreign Investment Board would benefit from a tax holiday for 10 years and tariff exemptions on all imported machinery and materials used in the project. However, to be approved, the project must have an economic net benefit to Solomon Islands in terms of positive foreign exchange, employment and regional development.

Generally, taxation concessions take the following forms:

(a) Tax holidays

Exemptions of income tax, withholding taxes and turnover tax on businesses for defined periods (three to six years) according to the rate of local value added in the export value (FOB) of the products produced.

Calculation of the local value added rate involves deduction from ex-factory sales of all expenditures involving an exchange rate loss, including expenditures incurred with respect to imports, management fees, expatriate salaries, loan interest and depreciation on imported equipment.

Companies involved in export of manufactured and processed goods, fresh seafood and fresh agricultural products may qualify for exemptions of income tax on trading export profits.

(b) Accelerated depreciation

Approved projects are granted accelerated depreciation on capital equipment and buildings (excluding land) equal to 50 per cent for tourist related projects (40 per cent write-off for factories) until claimed in full.

(c) Export market development

Approved projects are granted a 150 per cent tax deduction on all expenditure incurred in export market development and promotion.

(d) Training of local employees

Enterprises which sponsor apprentices and other employees in further training receive a double taxation deduction for all expenditures incurred.

(e) Inter-island transport

A 150 per cent deduction is allowed for the cost of inter-island transport of raw materials.

Import and export tariffs

(a) Imports

Generally, a 100 per cent exemption applies to all imports of raw materials, machinery and equipment for an approved project. Manufacturers importing raw materials for adding value obtain a 50 per cent exemption. Logging and fishing companies are granted a 100 per cent remission of duty. In many cases only a nominal duty rate of 3 per cent applies to all consumable goods used in a project. Full duty remission is normally applicable during the establishment phase of the project.

(b) Exports

All sawn timber, plywood, fish, spices and nuts are exported duty free. Logs of non-milling quality are subject to a duty of 22 per cent for logs with prices up to $SI 75 per m^3 and 25 per cent with prices above $SI 75 per m^3.

Abbreviations

ADB	Asian Development Bank
CDC	Commonwealth Development Corporation
CEMA	Commodities Export Marketing Authority
DBSI	Development Bank of the Solomon Islands
EDF	European Development Fund
EEC	European Economic Community
EIB	European Investment Bank
FAO	Food and Agricultural Organization of the United Nations
FIB	foreign investment board
GATT	General Agreement on Tariffs and Trade
ICSI	Investment Corporation of the Solomon Islands
IMF	International Monetary Fund
JICA	Japan International Co-operation Agency
LDA	Livestock Development Authority
NFD	National Fisheries Development Authority
SBFS	Small Business Finance Scheme
SIEA	Solomon Islands Electricity Authority
SIPA	Solomon Islands Port Authority
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
STABEX	Stabilization of Export Earnings from Agricultural Commodities
STL	Solomon Taiyo Ltd
UNDP	United Nations Development Programme
UNIDO	United Nations Industrial Development Organization

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Endnotes

1. TD/B/C.1/L.96, 21 November 1990, para. 12.

2. "Establishment of the work programme of the Standing Committee", TD/B/CN.1/8, 3 February 1993.

3. G.J. Ryland, *Pilot Project on Commodity Processing for Selected Developing Countries: Solomon Islands, Phases I and II*, papers presented at round table meeting of project INT/91/006, Honiara, Solomon Islands," 29 November to 4 December 1993.

4. Major constraints hindering domestic private-sector activity in respect to commodity-related diversification are the relatively few and slowly growing number of national entrepreneurs, who often lack the necessary initiative and technical, managerial and marketing skills; shortage of domestic capital; clan and family ownership of land and adjacent water; small, decentralized and fragmented domestic market; lack of knowledge of and information about export markets and export-marketing requirements; limited access to modern production and processing technology; high distribution costs, especially the cost of freight (both inter-island and international).

5. For example, the largest of the transnational corporations to operate in the forestry sector of the Solomon Islands, Lever Pacific Timbers, terminated its operations in 1986 owing to difficulties in obtaining rights to fell timber on lands held under customary ownership.

6. The other major source is fishing.

7. *The Courier* No. 132, 1992, p.34.

8. Central Bank of Solomon Islands, *Annual Report 1992*, p. 102.

9. South Pacific Regional Trade and Economic Cooperation Agreement, under which products from Solomon Islands and other Forum Island Countries of the Western Pacific enter Australian and New Zealand markets free of duty and quota restrictions.

10. Central Bank of Solomon Islands, *Annual Report 1991*, p. 4.

11. *Ibid.*, *Annual Report 1992*, p. 104.

12. There are 12 statutory authorities and 12 parastatal corporations in the country.

13. The total value of investment applications in the Solomon Islands amounted in 1991 to more than $SI 1 billion (US$ 0.37 billion). However, while a large number of projects was approved (71), only a quarter of them (18) were operating. The balance of projects previously approved have either been cancelled or rolled over into following years. This seems to suggest that many project applications were made in order to obtain concessions or licences while applicants were not really interested in project implementation.

14. In undertaking public works, the Government is not restricted by the land tenure system as it may benefit from its right to compulsory acquisition of land for the development of the public sector.

15. There is no railway in the country and formal sealed road networks are limited to areas around Honiara, Gizo and Auki. The balance of road capacity is unsealed roads or feeder roads used by logging companies and requiring four-

wheel-drive vehicles.

16. Honiara is the only port which receives general internationally traded imports. Two other major ports are devoted to commodity exports - Yandina to Lever Solomon (LSL) exports of copra, cocoa and coconut oil and Noro to canned fish and frozen tuna exports from Solomon Taiyo (STL) operations. Poor service and high cost of both public and private domestic inter-island shipping is a major constraint to the supply of production inputs to remote islands and to the marketing of products from these areas. Diversification prospects are restricted by an evident inadequacy of the cargo capacity of the inter-island shipping fleet which is at the level of 1,290 tons, of which 960 tons is operated by the private sector.

17. Air transport is relatively well developed, although the runaway at Henderson International Airport (Honiara) cannot take wide-bodied aircraft while terminal facilities need significant improvement.

18. The other marketing statutory authority is the Livestock Development Authority.

19. The copra price stabilisation scheme is subsidised by the government. For example, having depleted its reserves by supporting the domestic copra price in 1990, CEMA received about SI$ 2.5 million from the government (STABEX funds) in 1991.

20. Only around 10 per cent of round log production is currently sawn. The policy requiring a certain percentage of domestic processing of the total cut in every concession, regardless of location, area, species composition and stand density has resulted in inadequate mills at all concessions instead of good mills in the best locations. A similar problem was encountered in Papua New Guinea, which resulted in a declining wood processing sector.

21. Soltrust/Ecotimber, a company set up to promote sustainable-yield timber production, has made several trial shipments of sawn timber purchased from portable mills and chainsaws at a price which was double the average price of larger producers.

22. It should be noted in this connection, however, that export logs from the Solomon Islands generally yield lower values than comparable rainforest species (such as those from Papua New Guinea) as a result also of specie composition, smaller size of logs due to cyclones, more defects and variations as well as higher shipping charges.